

## LIONHEART OR PAPER TIGER? A FIRST-TERM KOIZUMI RETROSPECTIVE

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*Many commentators have opined as to the relative success or failure of Prime Minister Koizumi Junichiro's efforts to enact reform during his first term. This article analyzes the empirical evidence using a simple framework for assessment. The principal questions it asks are: What, if anything, has he accomplished thus far, and how will history remember his legacy? Following a summary of the circumstances that led to Koizumi's ascendancy and the political and economic conditions under which he governs, the article analyzes the results achieved in the prime minister's top three priority areas: banks, government spending, and regulatory reform. Despite the incremental progress achieved by Koizumi in the face of intense political opposition—most particularly from his own party—the article concludes that his current pace of reform is not likely to result in significant reform by the end of his second term as his party's president.*

**Key words:** Koizumi Junichiro, Liberal Democratic Party, regulatory reform, banking reform, privatization, *amakudari*

## Introduction

On May 27, 2001, the Sumo Grand Champion, Takanohana, won a miraculous, come-from-behind victory over his rival Grand Champion, Musashimaru. The crowd erupted into a frenzy as their injured hero pulled off an incredible upset. However, the greatest applause of the day did not go to Takanohana; it went instead to the presenter of the prime minister's cup—the prime minister himself, Koizumi Junichiro.

Rather than have a sumo official present the award on his behalf, as had been customary, Koizumi, fresh from his recent victory in the election for president of the Liberal Democratic Party (LDP), took advantage of his popularity to make a public appearance at Tokyo's *Kokugikan*. As soon as Koizumi emerged from the wings, he received an ovation befitting a rock star. Only in Japan would the people, who hold their politicians at a level of disdain unimaginable even in America, reserve their most enthusiastic response for a politician—and that in the presence of one of Japan's greatest sports heroes.

Koizumi was not expected to win the election as president of the LDP in April 2001. Considered a maverick and somewhat of an outsider, the veteran lawmaker had thrown his hat into the ring twice before, only to be defeated. Still his message of "Change the LDP! Change Japan!" resonated with the LDP rank-and-file, who were ready for change at the top.

Immediately upon his election, Koizumi's approval ratings with the public reached 85 percent, an unprecedented level for any prime minister in Japan's modern history.<sup>1</sup> He referred to himself as the "lionheart" in his own email newsletter, which had over 2 million subscribers during the peak of his popularity. The people liked him for his honest, straightforward talk, his sense of style, and his taste in music. (He is a fan of both opera and heavy metal.) Mostly, though, they liked him because he was different—different from the procession of bland, corrupt prime ministers who had preceded him.

The LDP, which was initially shocked by Koizumi's victory,

soon realized that Koizumi could be the savior of the party. Over the years, support for the LDP among the people of Japan had declined continuously to the extent that the LDP had to form a coalition with two other parties to remain in power in the 1990s. The LDP needed Koizumi, and he delivered. Due to Koizumi's overwhelming popularity, the LDP's fortunes were reversed with a solid victory in the upper house elections during the summer of 2001. Prior to Koizumi's ascendancy, the LDP had been expected to lose miserably.

Koizumi began his term with many promises of how he would make much-needed political and economic changes, and the voters believed he was sincere in his promises. Despite his continued popularity among the general population, however, his critics have been numerous. Opposition parties, and anti-reform lawmakers in the LDP, criticize Koizumi's inability to generate an economic turnaround. Voters are concerned about Japan's high unemployment rate. Foreign analysts criticize Japan's deflation and the lack of progress in political reform that would open up Japan's economy and allow for implementation of economic reforms.

The purpose of this article is to review the accomplishments of the Koizumi administration during his first term when matched against his stated intentions. What, if anything, has he accomplished? Is he the reformer he claims to be or simply one more in a long line of Japanese prime ministers who talk about reforms but spend their energies protecting the status quo? How will history remember the Koizumi legacy?

To address these questions, I suggest the following simple four-stage framework:

1. Publicized Intention	2. Symbolic Progress	3. Partial Success	4. Complete Success
Issue Identified	Action Plan Established	Interim Steps Taken	Issue Resolved

Stage One represents merely the statement of intentions to address an issue. Stage Two involves the introduction of a plan

1. "Koizumi naikaku shijiritsu 85% de rekidai saiko" (Support for Koizumi Cabinet at 85% Highest in a Generation), *Mainichi Shimbun* (Tokyo), April 30, 2001, online at [www.mainichi.co.jp](http://www.mainichi.co.jp).

of action. Though this stage does not represent measurable success, it could potentially represent a symbolic political victory that paves the way for future policy success. Stage Three represents measurable impact through action taken. Stage Four represents complete resolution of an issue.

A few caveats accompany this model. First of all, due to its simplicity, it does not capture all possible shades of gray within each stage, particularly within Stages Two and Three. Also, it does not distinguish between two distinct types of issues: those that are ultimately resolvable, such as privatization of a state-owned corporation, and those that are never completely resolved, such as efforts to reduce corruption or bureaucratic waste. To distinguish between these two categories of issues, we shall refer to the first type as a “resolvable” issue, and to the second type as a “perpetual” issue. As we apply this framework to the accomplishments of Koizumi’s first term, the difference between the two types of issues will become apparent. Issues of the second type, by definition, will never reach Stage Four, hence the separation of that particular box from the rest of the model.

We begin with a brief background on how Koizumi Junichiro came to be prime minister and the political and economic circumstances under which he governs.

### Background

The LDP’s overwhelming dominance since World War II has been ensured by an electoral system that allows for the representation of opposition parties in Japan’s parliament, the Diet, but that practically guarantees the inability of those opposition parties to win a majority of seats. Additionally, Japan’s parliamentary system allows the majority party in parliament to choose the nation’s prime minister. Typically, however, the vote by Diet members for prime minister has been a forgone conclusion as prime ministers have been selected by LDP party elders and faction leaders prior to any vote. Koizumi’s predecessor, Mori Yoshiro, was chosen by five such party elders meeting in a Tokyo hotel while the incumbent prime minister, Obuchi Keizo, lay comatose in the hospital.

### *Koizumi’s Election*

After Mori’s resignation in April 2001, however, there was a change in the voting rules for LDP president. Due to public outcry from the LDP’s 3.2 million rank-and-file members who were concerned about the party’s shrinking popularity (and who had never had any say in the selection of a prime minister) the LDP leadership decided to allow local prefectures to have what they thought would be a minor role in the next election. In addition to the vote among parliament members, each of the forty-seven prefectures was given three votes, most of which were based on a popular vote among party members in their respective prefectural organizations.

Because the prefectural vote took place before the parliamentary vote, many Diet members were shocked to find that 87 percent of the prefectural vote went to the charismatic Koizumi and only 11 percent to the LDP-anointed former prime minister, Hashimoto Ryutaro. The overwhelming support for Koizumi among the rank-and-file emboldened many parliament members to vote for Koizumi too. Though his margin of victory was considerably smaller in parliament, he still outpolled Hashimoto by 51 to 40 percent.

Even though reform supporters were encouraged by the rank-and-file’s selection of a party rebel, Koizumi became prime minister under conditions that were essentially the same as those faced by his predecessors over the prior decade: a declining economy and a political establishment that was inimical to change. Though an exhaustive analysis of Japan’s political and economic problems is beyond the scope of this article, a brief description is in order.

### *Japan’s Political Economy*

Since the bursting of Japan’s asset bubble in 1989-1990, the economy has suffered no fewer than three official recessions. Persistent deflation over the past four years has dampened consumer spending, one of the primary engines of economic growth. Throughout the 1990s, more and more Japanese firms were forced to abandon the long-held notion of lifetime employment and cut staff in order to survive, resulting in an unemploy-

ment rate that recently peaked at 5.6 percent, a postwar record. This came as a shock to Japanese who had grown accustomed to unemployment rates in the range of 1-2 percent.

The economy has also suffered from a lack of lending capacity as banks have struggled under the weight of as much as ¥60 trillion in nonperforming loans (NPLs).<sup>2</sup> The majority of these loans are to so-called “zombie” companies whose production methods are so inefficient as to ensure perpetual losses, yet whose loans continue to be rolled over year after year by their banks. If banks were to call in their loans to these companies, the economy as a whole would be struck by a domino effect. The immediate result would be the certain demise of many of these zombie companies, accompanied by massive unemployment. Additionally, many of the banks would be likely to go under as well. Those banks that did survive would be forced to accept public money in order to shore up their capital bases; in effect, they would be nationalized. Neither the unemployment nor the nationalization of banks would be a politically palatable solution to the ruling LDP.

A major side-effect of the NPL problem is that banks lack the capacity to lend to healthy and growing businesses. As a result, this engine that could potentially help Japan’s economy to return to the growth of the past lacks sufficient fuel. Without a healthy banking system, entrepreneurs with new business ideas have limited options for raising the capital necessary to turn their ideas into reality.

In the past, the habitual response of Japan’s government to economic downturn has been to spend massive amounts of public money to stimulate the economy. The construction industry has been among the prime beneficiaries of this government spending, which has flowed into the building of roads, dams, and bridges, not to mention the employment of an astounding 10 percent of Japan’s workforce. In recent years, however, this government largesse has not only failed to stimulate the economy

as intended. It has also added to a ballooning budget deficit projected to reach 10 percent of GDP, and to a public debt projected to reach 170 percent of GDP by 2004, the highest among all developed nations.<sup>3</sup>

Compounding Japan’s fiscal woes is a lack of options for monetary stimulus. Throughout the 1990s, the Bank of Japan (BOJ) steadily lowered interest rates in an effort to stimulate the economy by loosening the money supply. Over time, however, rates have been lowered to the extent that they no longer have an impact on the economy.<sup>4</sup> Though the BOJ has recently stepped up its purchases of Japanese Government Bonds (JGBs), Japan has not experienced a significant increase in its broad money supply.

Despite the intractability of Japan’s economic situation, most economists are in agreement that some combination of structural reform and monetary stimulus will eventually lead Japan back toward prosperity. Those favoring structural reform point to the necessity of dealing with Japan’s NPL problem by forcing the banks to face it squarely once and for all, and by forcing many of the “zombie” companies out of business, thereby freeing up capital for use by well-managed businesses. Among those who agree that monetary stimulus is needed, the general consensus is that the BOJ should be more accommodating to the government by buying more JGBs—in effect, printing money. The disagreement among economists is not over what needs to be done, but rather tends to be over the order in which structural reforms and monetary stimulus should take place—either simultaneously, or one before the other.

If there is general agreement as to the problems and their prescription then why has no action been taken? The answer to this question is of a political nature. With the exception of a few months in 1993-1994, postwar Japan has been ruled by a single party: the LDP. It has become almost cliché to say that the Liberal Democratic Party is neither liberal, nor democratic, nor a party.<sup>5</sup>

2. Official government statistics as of March 31, 2003 indicate ¥35.3 trillion in NPLs; however, estimates from the private sector range as high as ¥60-80 trillion, and a 2000 analysis performed by Goldman Sachs indicated NPLs of as much as ¥170 trillion. “What Ails Japan?” *The Economist* (London), April 18, 2002.

3. *Japan Country Report*, The Economist Intelligence Unit, online at [www.eiu.com](http://www.eiu.com).

4. Ten-year government bonds have recently yielded less than 1 percent and rates on short-term savings are less than 0.01 percent.

5. Roger W. Bowen, *Japan’s Dysfunctional Democracy: The Liberal Democratic*

The LDP is not *liberal* in the sense that a majority of its members are quite conservative, preferring the painful, yet tolerable, economic status quo to the even greater pain of economic reforms that could lead the electorate to vote for a sweeping change in leadership. The LDP's lack of democracy stems from its historical tendency to select leaders and decide policy in backroom negotiations that are hidden from view and, in general, are free from the influence of the public. The LDP is not a *party* in the true sense of the word as it is not bound by a common ideology. Rather, it is more like a group of factions with divergent beliefs and loyalties who are bound together only by a desire to remain in power.

At the center of Japan's political system is a so-called "iron triangle," a durable confluence of interests among Japan's bureaucracy, the ruling party, and big business. The bureaucracy consists mostly of graduates of Tokyo's top universities, all of whom are experts in their particular fields, and most of whom have held their respective positions longer than the cabinet minister to whom their ministry may happen to report at the moment.<sup>6</sup> Due to their longevity and expertise, these bureaucrats often have far greater influence on policy than the legislators who are elected by the voters. Parliament members need the cooperation of the entrenched bureaucracy in order to implement policy. In turn parliament members serve as a buffer between the bureaucracy and the electorate. As such they can ensure support among the electorate for their policies by delivering enough largesse to their respective districts. This also guarantees their continual reelection, and in some cases continued ability to line their own pockets with bribes and kickbacks from businesses that are granted huge construction contracts.

Businesses, on the other hand, benefit from a continuation of policies that hamper competition and ensure that the contracts

for service to the government continue to be available.<sup>7</sup> In return these businesses are generous with donations to the political machinery that assures the continuing dominance of the LDP. Completing the triangle, bureaucrats often "retire" to lucrative sinecures in the very companies whose industries they oversaw while serving the government, a practice widely known as *amakudari* or "descent from heaven." By providing such positions to retired bureaucrats, businesses are able to ensure a less meddling bureaucracy.

Despite the fact that Japan's voters continue to voice their displeasure with the ruling party (as evidenced by the LDP's gradual decline in power prior to the ascendancy of Koizumi), the durability of this iron triangle has been a major reason for the continued power of the LDP. In its position as the ruling party, the LDP, in collusion with the bureaucracy, controls the purse strings of a massive system of government-controlled special public corporations (*tokushu hojin*) and authorized corporations (*ninka hojin*), the largest of which receive upwards of half a trillion yen in annual subsidies.

Also within the government's purview is Japan's postal system that not only delivers the mail but administers the world's largest financial institution, which controls over ¥250 trillion in savings accounts and ¥123 trillion in insurance funds, dwarfing the funds managed by Japan's largest banks and insurance companies. The government is able, through its Fiscal Investment and Loan Program (FILP), to access these funds to subsidize a variety of the aforementioned government-controlled public corporations that manage various public works spending and investment programs.

Although the postal savings system functions somewhat like a bank, it has significant competitive advantages over banks. Unlike commercial banks, the postal savings system pays no taxes or deposit insurance premiums, and it is not required to maintain reserve funds at the Bank of Japan. Furthermore, each of the over 24,000 post offices nationwide serves as a branch,

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*Party and Structural Corruption* (Armonk, N.Y.: M.E. Sharpe, 2003), p. 45; Patrick Smith, *Japan: A Reinterpretation* (New York: Vintage Books, 1997), p. 298.

6. In order to allow the various faction and coalition members to have their turns as ministers, cabinets have traditionally been frequently reshuffled. Japan has had over 200 cabinet ministers in the past twelve years. See Ohara Ichizo, "Stick to Your Guns, Koizumi," *The Asian Wall Street Journal*, July 2, 2003, p. A7.

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7. Among such businesses are the large "zombie" companies, as well as small- and medium-sized companies, including "mom and pop" businesses. World-class Japanese companies such as Sony and Toyota are not counted among these businesses.

and letter carriers often pull double duty, delivering withdrawals and picking up deposits as they deliver the mail. Over the years, the 150,000-strong postal workers union (*zentei*) has always been counted on to help the LDP organize the rural vote, a key to the LDP's continued dominance. And the postal service has long been a favorite of rural dwellers because of the personalized service it provides.

Despite the positive benefits the postal service provides to those living in the countryside, its negative effects on Japan as a whole are significant. Not only does the postal savings system undermine the private sector, further weakening Japan's sickly banks; it also continues to funnel money to wasteful, inefficient infrastructure projects favored by the LDP.

With that as background, let us now take a look at the various reforms that have been proposed by the Koizumi government and the progress achieved during his first term.

### Koizumi's Priorities

While campaigning for LDP president in April 2001, Koizumi's message emphasized three major themes: cleaning up the banks, dealing with Japan's massive public debt, and undertaking regulatory reform.<sup>8</sup> The last of these, in many senses, was a polite euphemism for political reform as it struck at the very heart of the LDP's dominance. These reforms were the basis for a manifesto released by the Council on Economic and Fiscal Policy (CEFP) on June 26, 2001.

The previously discussed framework can be applied to Koizumi's three major themes as follows:

1. *Cleanup of the banks.* The most measurable outcome would be a reduction in nonperforming loans. This would appear to be a "perpetual" issue as even the healthiest banks have nonperforming loans; however, it only becomes a problem when the

8. Missing from this list is the revision of Article 9 of Japan's constitution, which renounces Japan's right to use military force. Though this is a significant issue that may certainly have a collateral impact on his ability to enact other reforms, Koizumi only vaguely addressed it during his campaign for LDP president.

amount of such loans exceeds a predetermined level. As we shall see, the level of NPLs in Japan is far above any level deemed to be acceptable. Though "resolvable," this issue is far from being resolved.

2. *Reduction of public debt.* Similar to the banking issue, this issue does not become resolved when public debt reaches zero, but rather when public debt reaches some acceptable level. It is also a "resolvable" issue.
3. *Regulatory reform.* This involves a host of issues that fall into both the "resolvable" and the "perpetual" categories.

### Cleaning Up the Banks

The task of cleaning up Japan's banks carries with it the added burden of either closing or rehabilitating the companies whose NPLs the banks currently hold. Together, these activities constitute the bulk of the structural reform component of Koizumi's plan.

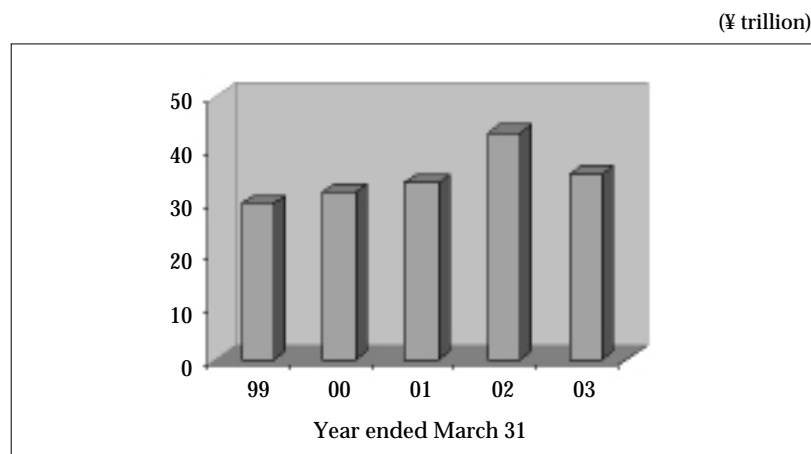
Actions outlined in the initial proposal included monitoring the progress of banks in handling their NPL problems and working with banks to more strictly classify the financial conditions of debtor companies. It was further proposed that the functions of the Resolution and Collection Corporation (RCC) be strengthened to facilitate the disposal of NPLs.

These initial proposals for improved monitoring and classification were not exactly ground-breaking reform as they essentially repeated earlier vows by the Financial Services Agency (FSA); however, statistics released by the FSA since Koizumi's election have indicated a marked increase in officially-designated NPLs from 2001 to 2002 (see *Figure 1*). According to the FSA, the primary reason for the increase in NPLs from 2001 to 2002 was "stricter application of classification criteria." The decrease from 2002 to 2003 was due to "aggressive efforts of banks to remove NPLs from their balance sheets."<sup>9</sup>

Originally established by the merger of two government agencies on April 1, 1999, the RCC was intended to purchase NPLs from Japanese banks, thereby freeing up capital for lending to healthy companies. The concept was for the RCC to operate

9. FSA website, online at [www.fsa.go.jp/indexe.html](http://www.fsa.go.jp/indexe.html). Accessed August 4, 2003.

Figure 1. Total Nonperforming Loans



similarly to America's Resolution Trust Corporation (RTC), which was established to resolve the savings-and-loan (S&L) crisis of the 1980s. The Koizumi government's initial reform at the RCC was to allow securitization of nonperforming loans for sale to investors, providing a further mechanism for clearing up the balance sheets of banks and allowing for more productive use of capital.

By 2002, however, it became clear that RCC takeover of loans had not increased significantly as the RCC was plagued by other issues. Of primary concern was the fact that, according to law, the RCC could not lose money on any transaction. This required a rigorous and time-consuming approval process that could reach all the way to the level of the prime minister. Additionally, because the RCC could pay no more than market value for the loans it purchased, banks had little incentive to admit failure and hand loans over to the RCC. This also meant that the RCC was generally able to purchase only loans that the banks thought they had no chance of collecting, even in the event of an economic recovery.

The solution to this dilemma came in 2002 when the Koizumi government allowed the RCC to begin purchasing loans at book value in what amounted to an injection of public funds into banks. Due to this loosening of the rules, purchases of NPLs

increased dramatically in fiscal 2002 (see *Table 1*). The higher percentage of loan value purchased in the year ending March 31, 2003 reflects higher values that the RCC was allowed to pay to acquire loans.

*Table 1.* Value of Loans Purchased, Purchase Price, and Purchase Price percent of Value

	2000	2001	2002	2003
Value of Loans Purchased (¥ billion)	451.0	522.2	330.2	2,088.5
Purchase Price (¥ billion)	21.7	12.6	20.6	205.7
Purchase Price percent of Value	4.8 %	2.4 %	6.2 %	9.8 %

Source: Deposit Insurance Corporation of Japan website: [www.dic.go.jp/index.html](http://www.dic.go.jp/index.html).

Despite the Koizumi government's early commitment to cleanup of the banking system, Koizumi encountered resistance from both his Minister of Financial Affairs, Yanagisawa Hakuo, and the FSA's chief bureaucrat, Mori Shoji, both of whom continued to insist that their previous measures had begun to improve bank conditions. Koizumi's response to this resistance yielded mixed results. When Mori stepped down in the summer of 2002, Koizumi, rather than appoint a reformer to take his place, appointed a close ally of Mori. However, Koizumi redeemed himself in the eyes of reformers a few months later, when he forced out Yanagisawa during a cabinet reshuffle, handing his portfolio as Financial Affairs Minister to the existing Economy Minister, Takenaka Heizo. Takenaka, a reputed reformer, is one of a handful of cabinet ministers whom Koizumi recruited from the private sector.

In an indication of just how groundbreaking Takenaka's initial reform proposals were expected to be, senior LDP members began to attack his plans before they were even released to the public. Central to Takenaka's initial plan was a proposal to change how banks calculate their capital ratios, by disallowing all or a portion of deferred-tax assets that banks were able to include as part of their tier-1 capital.<sup>10</sup> The ostensible purpose of

10. Deferred tax assets amount to tax credits that banks can use to offset

the reclassification was to force banks into accepting public money, thereby subjecting them to more rigorous loan write-offs and forced changes in management. Takenaka, who had previously declared in a magazine interview that no bank or company was too big to fail, scared anti-reformers in the LDP who feared a backlash from the public over the increase in corporate bankruptcies and potential massive unemployment.

In a great disappointment to pro-reformers, the plans that Takenaka ultimately released to the public on October 30 were watered down significantly, containing only the usual commitment to strengthen inspections and improve monitoring standards. The LDP had succeeded once again in staving off real reform that would have closed zombie companies and cleaned up bank balance sheets through the injection of public funds.

Takenaka was further thwarted by the Bank of Japan, which resisted his appeals to cooperate with governmental reforms by taking more drastic measures to loosen the money supply and stimulate demand. In a pattern that has been the hallmark of the Koizumi administration, Takenaka would have to become accustomed to taking three steps forward and two steps back.

In a compromise to his initial plan, Takenaka proposed the formation of the Industrial Revitalization Corporation of Japan (IRCJ), which was approved by the Diet on April 1, 2003. Different from the RCC, the IRCJ is designed to identify problem borrowers that still have promising products or marketable technology, take over all loans except for those from their core bank, then work with the company and the core bank to rehabilitate the company and turn it into a thriving, profitable company. The IRCJ is staffed by experts from the private sector who are experienced in such turn-around projects. Though only funded with ¥50 billion initially, it was expected that the IRCJ would receive further funding if its efforts proved successful. The IRCJ began work in the fall of 2003. Among its first “clients” were a chemical trading company, a bus operator, a department store, and a mining company—hardly exemplary of the best technology

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future tax liability for up to five years. Of course, these assets would be worthless if banks earn no profits in the ensuing five years (a likely prospect for many banks), nor would they have any value if a bank failed in the interim.

Japan has to offer.

Takenaka’s previously stifled plan for handling deferred tax assets appeared to be somewhat vindicated in May 2003 when Japan’s fifth largest bank, Resona, required a government bailout. Takenaka had been unable to force change in the traditional way, by getting a bill passed in the Diet, so he teamed with Okuyama Akio, chairman of the Institute of Certified Accountants, to put pressure on Japan’s accounting firms. In a meeting with the heads of Japan’s thirteen largest accounting firms, Okuyama reminded them of the demise of Arthur Andersen after the Enron scandal. The message was clear when Okuyama told the accountants, “[Arthur Andersen] was a 90-year-old company, gone within six months.”<sup>11</sup>

Following pressure from Takenaka and Okuyama to get tough on the banks, Resona’s auditors pressed the bank to exclude a portion of deferred tax assets from its capital calculation. At the time, 70 percent of Resona’s capital consisted of these deferred tax assets, and auditors refused to certify their financial statements unless at least 40 percent of deferred tax assets were excluded. This forced the bank to admit that its capital adequacy ratio had fallen to approximately 2 percent, less than half of the requirement for Japanese banks. Koizumi agreed to a bailout of Resona. He injected up to ¥2 trillion of public money, effectively nationalizing Resona, and allowed the FSA to replace all of Resona’s top management.

In a further sign that the FSA is becoming more stringent in its oversight of the banks, fifteen banks that had previously received government funds were warned on August 1, 2003 to improve their earnings by the end of the fiscal year on March 31, 2004. The FSA has the authority to take further action against a bank if it misses its earnings targets by 30 percent or more. Because the FSA holds convertible preferred shares in the banks, it has the option to effectively nationalize the banks by converting the preferred shares into common shares. It could also force resignations of senior bank management.

In summary, the first two years of bank reform under the Koizumi administration have yielded both wins and losses. The

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11. Martin Fackler, “Unlikely Team Sets Banking in Japan on Road to Reform,” *The Wall Street Journal*, August 6, 2003, p. A1.



most stringent elements of reform to the banking system continue to encounter resistance from both the LDP and the bureaucracy; however, recent actions by the FSA and RCC appear to be having an impact on the size of the NPL problem. The addition of the IRCJ to help rehabilitate salvageable borrowers beginning in the fall of 2003 should also contribute to a gradual decrease in NPLs, but its impact will be negligible in the short term. Whether the IRCJ will achieve any progress with its current slate of zombie clients remains to be seen.

Based on a combination of publicly announced plans and actual steps taken, this issue would seem to straddle the line between Stages Two and Three in our framework. Nevertheless, Japan's economy continues to suffer from the lack of a vibrant banking system that could lend capital to support economic growth. The economy will not improve until considerable progress is made in reducing the NPL burden—that is, until this issue begins to approach Stage Four.

#### *Addressing the Budget Deficit and National Debt*

Koizumi's initial tactic for reining in government spending was to limit issuance of new debt to ¥30 trillion every year, beginning with fiscal year 2002.<sup>12</sup> He also stated his aim to return the budget to primary balance by 2010, meaning that any new debt issued would only go toward servicing existing debt. In terms of spending cuts, Finance Minister Shiokawa Masajuro told the Diet in June 2001 that the prime minister wished to cut public works spending in half over ten years, a notion that would have made the LDP old guard gasp had they actually believed it was possible.<sup>13</sup>

Unfortunately, Koizumi had little success in reforming the Diet's profligate ways during fiscal 2001 as the Diet subsequently passed *two* supplementary budgets before the end of the fiscal year. The first supplementary budget sent total borrowing for

the year to Koizumi's limit of ¥30 trillion. The second was partially funded by sales of NTT shares that the government had previously set aside for bond repayment. With that action the Koizumi government was already resorting to accounting tricks in order to stay within the arbitrary ¥30 trillion new bond issuance limit.

For years, Diet members had counted on the passage of one or more supplementary budgets each year in order to obtain funding for various pet projects. These budgets were always characterized as stimulus packages, although little evidence exists to prove their stimulative effects. The fiscal 2002 budget, on the other hand, represented a victory of sorts for Koizumi as he was able to get a budget passed that cut spending by ¥5 trillion, or 1.7 percent of the 2001 budget. This budget included a 10 percent cut in public works spending and a 10 percent cut in foreign aid, augmented by an increase in required medical co-payments by salaried workers from 20 percent to 30 percent. Most importantly to Koizumi, this budget adhered to the ¥30 trillion cap in new debt issuance, despite the fact that many economists and the IMF warned that strict adherence to spending cuts during a period of declining corporate profitability and tax revenue could send the economy into recession.

The customary calls for a supplementary budget in 2002 began almost as soon as the regular budget was approved by the Diet, and grew to a crescendo in late 2002. After repeated denials that he would seek a supplementary budget 2002, Koizumi finally bowed to pressure from the LDP coalition and the construction industry. The added reality of below-plan tax revenue during 2002 made a supplementary budget all but inevitable, and the Diet passed the extra budget in January 2003. This budget not only increased spending but called for the issuance of an additional ¥5 trillion in debt, bringing the total new debt issued for fiscal 2002 to ¥35 trillion, ¥5 trillion over Koizumi's pledged limit.

Koizumi's 2003 budget likewise called for new bond issuance in excess of ¥30 trillion, but it also included further cuts to public works and foreign aid of 3.7 percent and 5.8 percent, respectively. Despite these cuts, for the first time in three years, Japan's initial fiscal year budget was larger than the previous year's budget.

12. Koizumi later decided the ¥30 trillion cap should also apply to fiscal year 2001. Japan's fiscal year 2001 began on April 1, 2001.

13. Shiokawa resigned his Diet seat after Koizumi dissolved the lower house in October of 2003, and was replaced as finance minister by Tanigaki Sadakazu.

Compared to his modest progress in handling the bad loan situation, Koizumi has been less successful in managing Japan's budget. Despite the setbacks, however, Koizumi managed a few small victories. The politically sensitive budgets for public works were cut by 10 percent in 2002 and 3.7 percent in 2003.<sup>14</sup> Under a more pliant prime minister, the construction lobby and senior LDP members would have been more likely to force through even larger supplementary budgets containing trillions of yen in customary public works spending. Due to some of his smaller victories, Koizumi can legitimately point to partial success on this issue. Again, this issue seems to be one that straddles the line between Stages Two and Three of the assessment framework.

### Privatization and Regulatory Reform

Koizumi has pursued regulatory reform with much vigor since his election. Key among his reform targets is Japan's post office. To his first cabinet he appointed one of the LDP's "young Turks," Ishihara Nobuteru, as Minister of State for Administrative and Regulatory Reform to oversee a Margaret Thatcher-style program of privatization or closure of the government's 163 public corporations.<sup>15</sup> In his very first speech as prime minister, Koizumi declared that "all that can be accomplished by the private sector should be left in the hands of the private sector."<sup>16</sup>

14. It bears mentioning, however, that there seems to be little consensus among economists as to whether expense reduction should rank higher in priority than fiscal stimulus in Japan.

15. After Koizumi's reelection as LDP president in September 2003, Ishihara was appointed to a different position, that of Minister of Land, Infrastructure and Transport. Ishihara's portfolio of regulatory and administrative reform was reassigned to Kaneko Kazuyoshi, a former banker and current LDP Diet member.

16. Koizumi speech to his new cabinet on April 26, 2001 as quoted from the prime minister's website at [www.kantei.go.jp/foreign/koizumispeech/2001/0426setuji\\_e.html](http://www.kantei.go.jp/foreign/koizumispeech/2001/0426setuji_e.html). Accessed August 5, 2003.

### The Post Office

In addition to its 24,000 nationwide branches, Japan's post office controls the postal savings and insurance systems. Together they comprise the largest financial institution in the world. Reform of this juggernaut would not only ensure a more level playing field for Japan's moribund banking sector; it would also deprive the LDP and the bureaucracy of a massive source of funds for wasteful, pork-barrel spending on public works projects.

Years before his election as prime minister, Koizumi made the eventual privatization of the post office one of his pet issues. In 1997, while serving as Minister of Health and Welfare in the cabinet of former Prime Minister Hashimoto, Koizumi was one of the main instigators behind proposed post office reform. So insistent was he that the Hashimoto government follow through on its proposed reforms that he threatened to resign if Hashimoto allowed the reforms to be watered down.<sup>17</sup>

Koizumi's first order of business in 2001 was to appoint an advisory panel of private sector experts to recommend reforms and a plan for implementation. Little was accomplished in 2001, however, aside from the occasional verbal missiles fired between Koizumi and members of the LDP's "postal tribe," a group of lawmakers whose key area of expertise lay in overseeing and protecting the postal system.

Resistance grew in 2002 as Koizumi prepared to introduce a bill to the Diet that would begin the privatization process for all three of the post office's business lines: mail, savings, and insurance. The more LDP stalwarts resisted reform, the more shrill the public comments that flew between the two sides. At one point Koizumi declared: "Either the Liberal Democratic Party crushes the Koizumi administration or the Koizumi administration crushes the party."<sup>18</sup> He even threatened to dissolve the lower house of parliament and call a snap election if his reforms were not passed.

The LDP's anti-reform inertia proved too strong for Koizumi, as every bill he proposed became altered beyond recognition. A

17. The reforms were ultimately watered down, yet Koizumi did not resign.  
18. "Changes are Short of a Privatization Milestone," *Asahi Shimbun* (Tokyo), July 5, 2002.

bill designed to allow private businesses to compete with the post office in mail delivery was intentionally weighed down by numerous conditions that made the prospect of delivering mail completely unattractive to private businesses. Yamato Transport, a private business that had been considering the opportunity to compete with the post office, announced that it no longer wished to enter the mail delivery business as the LDP had burdened the bill with too many rules and regulations. As discussions ensued in the summer of 2002, Koizumi found himself increasingly isolated between the LDP, which resolutely resisted the notion of privatization, and the media (both Japanese and foreign), which lambasted the prime minister for compromising on his key reform initiative.

The only reform that passed the Diet, on April 1, 2003, was a compromise that allowed the mail delivery business to be transformed from a government agency into one of Japan's "public corporations." The bill also provided an opening for private companies to compete in mail delivery. Though a far cry from the privatization bill Koizumi had hoped for, the new Japan Post, as a public corporation, would—for the first time ever—be required to focus on profitability. Unfortunately, simply being designated a "public company" does not ensure that Japan Post achieves profitability. Many of Japan's other 163 public corporations have been consistently unprofitable.

The greatest disappointment was the fact that the new bill did not even address the savings and insurance businesses, the main reasons for wanting to privatize in the first place. Having a loss-making postal delivery system is no great sin in the eyes of the developed world. Even the U.S. Postal Service, which still retains a monopoly on letter delivery, has relied on generous government subsidies over the years. By further alienating the anti-reform wing of his party, Koizumi wasted a lot of political capital only to pass a bill that did not touch the aspects of the postal system that were most in need of reform.

By this time, much of the world had written off Koizumi as ineffective and not serious about reform. Nevertheless, emboldened by a surge in popularity after his visit to North Korea in September 2002, Koizumi pressed on with his reform agenda. Appointed to run the new Japan Post was Ikuta Masaharu, a shipping industry executive who had been a strong supporter of

Koizumi's privatization initiative. Additionally, Ikuta was appointed, along with fourteen other business and industry leaders, to serve on a committee to map out how the new public corporation would operate and to begin discussions on the roadmap to eventual privatization.

As the new Japan Post began operation on April 1, 2003, Ikuta brought in a group of physical distribution experts from Toyota to study every aspect of the postal delivery business and recommend changes. Additionally, despite the early misgivings of Yamato Transport, competitors for the mail delivery business began to emerge. Though none of the private delivery companies had yet begun to deliver mail, several were beginning to challenge Japan Post in special delivery services for small parcels. Also, when Yamato began targeting sales catalog companies in May 2003, Japan Post responded by decreasing its corporate bulk mail rate by 9.2 percent. Competition yielded benefits for customers, but would private companies have deep enough pockets to compete with a government-sponsored corporation?

One encouraging sign occurred in March 2003 when the 150,000-member Japan Postal Workers' Union held its first meeting since 1997 to discuss reaction to the changes. Having previously banded together to resist reform attempts, this group agreed to adopt the slogan of "self-reform," seeing privatization as inevitable and wanting to have a hand in shaping its outcome.

After the close of the Diet session in the summer 2003, Koizumi once again threw down the gauntlet to challenge anti-reformers in the LDP. He reiterated his determination to pass a privatization bill, this time vowing that all three postal businesses would be privatized by 2007. After Koizumi's reelection in September 2003, however, the revised party platform contained no firm dates for the achievement of privatization, only a plan to decide upon a date during 2004.

Koizumi's performance on privatization of the Post Office has likewise produced mixed results. The fact that he was able at least to open the mail delivery business to competition when it was previously untouchable represents a partial success. His persistence in keeping this "third rail" issue alive over two and a half years, despite his inability to take any action on the savings or insurance businesses, represents symbolic progress at best.

### Administrative Reform

Whereas postal reform would deprive the LDP of a massive *source* of funds, the reform of Japan's public corporations would deprive the party of a massive *use* of funds. Japan's bureaucrats also have a vested interest in the continued status quo of the public corporations, which through the practice of *amakudari* represent a lucrative retirement program for many.

Designated to head up Koizumi's reform plans for the public corporations was Ishihara Nobuteru, who was only forty-four years old at the time of appointment as Minister of State for Administrative and Regulatory Reform. Son of the outspoken Tokyo governor, Ishihara Shintaro, and a former journalist, Ishihara became the second youngest member of Koizumi's cabinet. The appointment carried with it responsibility for the bulk of reforms that Koizumi intended to enact during his administration, including:

1. **Reform of Japan's 163 public corporations and authorized corporations.** Koizumi's directive to Ishihara was either to privatize or abolish all 163. Those that could not be privatized or abolished should be reformed and/or pushed out to the local level.
2. **Reform of Japan's approximately 26,000 tax-exempt "public interest corporations."** Those engaging in for-profit activities should have their tax-exempt status revoked, and all should be reformed by competent, professional managers rather than retired bureaucrats.
3. **Reform of the Public Service Personnel System** using private-sector performance management criteria.
4. **General deregulation** to reduce government red tape and create a more favorable environment for business.

We shall view each of Ishihara's initiatives in turn.

### Public Corporations

In spring 2002, the Koizumi government was successful in passing bills to dissolve the Japan National Oil Corporation (JNOC) and the Metal Mining Agency of Japan (MMAJ). The most contentious debate, however, was reserved for the reform

of Japan's four road infrastructure companies.<sup>19</sup> These four entities are among the most wasteful and highly subsidized of the public corporations and have served as a traditional source of pork-barrel spending for LDP lawmakers. Rather than privatization, however, the outcome was merely a bill that allowed the prime minister to appoint a panel of third-party experts to study the issue and present a plan to the Diet at a later date.

Not only were lawmakers able to stall real reform, they were also successful in resurrecting thirteen road construction projects that had previously been cancelled by the Koizumi administration. As it turned out, several of the previously cancelled projects had been in the home districts of senior LDP lawmakers, including that of former Prime Minister Hashimoto.

This debate also coincided with Koizumi's firing of his controversial but extremely popular foreign minister, Tanaka Makiko, in January 2002. Prior to her firing, Koizumi's approval ratings had been in the 70-80 percent range. The next day his approval ratings plunged to 45 percent. LDP lawmakers probably saw this plunge in popularity as a potential vulnerability and acted to block any moves toward privatization of their prized road corporations.

Later in the year, due in part to a boost in popularity after his September 2002 visit to North Korea, Koizumi's agenda proved much more successful in a special fall 2002 Diet session when forty-six bills were passed calling for the restructuring of 118 public corporations. However, restructuring is far from the original goal of privatization or abolition. As of fall 2003, eight public corporations have been abolished and eleven have been privatized, with many more in process. Progress has obviously been achieved with a handful of the public corporations, so much of this effort remains at the symbolic Stage Two. Assuming Ishihara's successor pursues these reforms with equal vigor, this area would appear to have reached Stage Three.

19. The Japan Highway Public Corporation, Metropolitan Expressway Public Corporation, Hanshin Expressway Public Corporation, and the Honshu-Shikoku Bridge Authority.

### *Public Interest Corporations*

Unlike “public corporations” that are established by parliamentary law, “public *interest* corporations” are established under the approval of either the central or prefectural governments. These public interest corporations, many of which are charitable or arts-related foundations, are generally tax-exempt.

Over the years, the public interest designation has been abused. For example, a golf course achieved public interest status for its role in promoting sports. Also, a wealthy individual gained public interest status for establishing a foundation that promotes culture, gaining for himself an exemption from the inheritance tax. Many public interest corporations have been established by ministries, and then—through *amakudari*—have been staffed by retired bureaucrats who had formerly overseen the corporations. As of October 2000, over 6,000 retired bureaucrats held managerial positions in 2,469 public corporations.

Koizumi and Ishihara began steps toward reform of these organizations early in the administration, but have been thwarted by the sheer inertia of the over 26,000 public interest corporations and the bureaucrats in their sponsoring ministries. Measures to curb the practice of *amakudari*, to improve the oversight of these organizations, and even to change the laws that govern their establishment have been mooted, but as of this writing, no action has been taken. This particular issue remains stalled between Stages One and Two.

### *Public Service Personnel System*

In order to improve the performance of the civil service and reward outstanding performance, the Koizumi government considered several progressive measures. Chief among them was an effort to replace the current seniority-based salary system with a performance-based system. Criteria would be adopted to rank the performance and abilities of state employees, and those who failed to meet the criteria could face demotion. Additionally, measures were being considered to revise the practice of *amakudari*.

As of this writing, no bills have been introduced to the Diet. Ishihara had planned to introduce a bill in summer 2003, but withdrew it at the last minute due to disagreements with the

National Personnel Authority. Ishihara’s successor at the beginning of Koizumi’s second term has yet to announce any intentions regarding this issue. As it continues to languish at the talking stages, this issue merits a “Stage One.”

### *Deregulation*

In April 2001, the Council for Regulatory Reform was established to advise the cabinet on matters of regulatory reform. Reporting to Ishihara, the Council recommended to the Cabinet in March 2002, a program of deregulation that contained 599 specific proposals. As of the end of September 2002, Ishihara reported to the Cabinet that his organization had already implemented 205 of the proposals, eighty-eight of them ahead of schedule. Though many of the proposed actions were minor, together they constituted a major assault on the mountains of bureaucratic red tape that have become a hindrance to doing business in Japan.<sup>20</sup>

Probably the most significant deregulatory action taken by the Koizumi government was the passage of a bill allowing the establishment of Special Zones for Structural Reform. Perhaps taking a page from China’s success with its Special Economic Zones, Japan’s Special Zones were designed to be areas with less regulation, allowing for new business ideas to be implemented and tested at the local level, and creating an environment more encouraging to foreign investment. Local jurisdictions could now apply for permission to establish special zones, and upon approval, these zones would be free from certain restrictive rules that applied to the rest of the nation such as those on business practices, operating hours, immigration and visa requirements, building permits, and business establishment of schools.<sup>21</sup> The

20. Among some of the annoying rules scrapped were a rule requiring that part-time workers in kindergartens could comprise no more than 20 percent of staff, and another rule requiring that the senior managing directors of all hospitals must also be medical doctors. Rules were also enacted to lower the required qualifications of foreign information technology employees working in Japan and to allow temporary workers to be contracted for up to three years as opposed to the current one-year limit.

21. Among the categories of special zones are education, physical distribution, international exchange, agriculture, urban development, new energy

central government plans to use these Special Zones as experiments and ultimately implement successful strategies in other areas of Japan.

Local governments enthusiastically embraced the concept and submitted more than 1,000 proposals in the initial application rounds. As of this writing, the government has accepted 140 proposals for zones that are now in the process of being established.

In a June 2003 symposium in San Francisco sponsored by JETRO, Kose Toshihiro, Chief Executive of the Special Zone established by the city of Kitakyushu, spoke of his city's success in establishing a special port as a gateway to Asian shipping. The flexibility of the Special Zone allows Kitakyushu to provide customs clearance twenty-four hours a day, 365 days a year. Kitakyushu is now able to use its superior infrastructure to compete more effectively with other regional ports in East Asia. Though pleased with the relaxation of bureaucratic red tape, Kose expressed his desire for the government also to consider allowing the use of tax incentives in Special Zones.

The solid progress achieved under the heading of deregulation and the establishment of the Special Zones, which are already up and running, represent a significant Stage Three victory for the Koizumi administration.

### Summary of Results

Though Japan continues to be plagued by its NPL problem, incremental progress has been achieved in dealing with Japan's banking system. By official measures, total nonperforming loans decreased by 18 percent from fiscal 2001 to 2002, while the RCC increased by more than six times the value of NPLs it purchased from banks during the same period. Also, though legislative efforts have yielded few results, Takenaka was able to apply pressure to bank auditors to begin tightening their standards for evaluating bank capital.

Koizumi has had less success in dealing with Japan's deficit, which remains in excess of 9 percent of GDP, and Japan's national debt, which is projected to reach 170 percent of GDP in 2004.

and recycling, reform of local government, welfare, and medical- and industry-university collaboration.

Though better judgment probably convinced Koizumi that an austerity budget was not advisable during the current economic downturn, he still managed to cut wasteful spending from the public works budget two years in a row.

In terms of regulatory reform, the Koizumi government achieved some modest gains during the first term. Ishihara Nobuteru continued to push through minor changes in rules and regulations and also achieved success in gaining approval of bills requiring the privatization, closure, or restructuring of over one hundred of Japan's public corporations. Koizumi continues to encounter fierce resistance among both lawmakers and the bureaucracy over the privatization of the post office and the four road corporations that represent much of Japan's wasteful pork-barrel spending. The establishment of the Special Zones for Structural Reform, however, is a positive step in allowing local jurisdictions the flexibility to carry out their own experiments in deregulation.

Table 2 provides a summary of progress vis-a-vis the framework.<sup>22</sup> In all but two categories, visible progress is evident; however, the gap between actual and potential progress looms large over Koizumi's second term.

Table 2. Koizumi's Performance vis-à-vis the Proposed Framework

Reform	Actual Stage	Potential Stage
Bank Reform	3	4
Public Debt / Gov.'t Spending	2-3	4
Regulatory Reform		
Post Office	2-3	4
Public Corporations	3	4
Public Interest Corporations	1	3
Public Personnel System	1	3
Deregulation	3	3

22. We shall resist the temptation to compute an overall quantitative score as the various reforms involve differing levels of complexity and importance, and thus would necessitate the introduction of subjective weighting factors.

### How Will History Remember the Koizumi Legacy?

Is Koizumi Junichiro the lionheart that he has claimed to be, or simply a paper tiger who wants to hang on to power as long as he can? As we have seen, he has so far achieved mixed results on his reform efforts; however, in light of the evidence, we must conclude that the lack of complete success is not due to a lack of effort. In fact, one could argue that Koizumi has been among the most persistent of Japanese prime ministers in recent years. Koizumi told the electorate that he intended to privatize the postal system before he was ever elected, and despite the continued setbacks, he continues to insist that privatization is his ultimate goal. In the midst of his battle with the LDP over privatization in April 2002, Koizumi told the Japanese journal *Chuo Koron*, "I know there are many people worrying about the prospects for my reform program, but there will be no change in my resolve to transform Japan's structures, no matter what happens to my support figures."<sup>23</sup> These are certainly not the words of a prime minister who wants to remain comfortably ensconced while making as few waves as possible.

Despite the intransigence of the LDP, whose leadership has had some success in blocking the most audacious of Koizumi's proposals, the majority of voters in Japan express support for him. They admire his willingness to challenge the LDP, and they like his straight talk, his unconventionality and his dauntless pursuit of reform. Certainly, he lost some of the people's support after he fired Tanaka Makiko in January 2002; but he has since regained some of that lost popularity through other bold moves such as his trip to confront Kim Jong Il in Pyongyang in September 2002. His approval ratings at the end of 2003, which surged from around 50 percent to 65 percent after his reelection as LDP president, then returned to the 50-percent level after the November 9, 2003 lower house election, are still higher than most prime ministers have ever enjoyed.<sup>24</sup>

Still, the world remains disappointed in his lack of progress. Perhaps it is because some people believed that he would immediately accomplish everything he had promised. Yet this belief could not have taken into account the reality of Japan's political system—the entrenched old guard of the LDP who are resistant to any change, the intractable bureaucrats determined to protect their way of life, and the system that they all so jealously guard.

Consider for a moment that Koizumi, the son and grandson of former lawmakers, and a Diet member himself for thirty years, knew exactly what he was doing. From experience, he knew how vehement the resistance to his reforms would be, yet he ran his campaign based on a platform of change so drastic as to shake the very foundations of Japan's political order. Against all odds, Koizumi was shoved into the spotlight overnight by the LDP rank-and-file who were ready for a change. His sudden popularity with the people was so overwhelming that the senior leadership realized they had in Koizumi an opportunity to resurrect the party's declining popularity. Indeed, history has shown that "defections are common when the LDP is popular, but rare when the LDP is popular and powerful."<sup>25</sup> Here was the LDP's opportunity to shore up support, among both the membership and the voters.

How ironic it is, though, that the LDP old guard hates everything Koizumi stands for yet needs him to appeal to the people so it can retain power. How ironic it is that Koizumi appears determined to destroy the power base of the very party that allows him to remain as its president.

There are three conditions that allow this circumstance to continue. First, Koizumi is among the most popular prime ministers in modern history. Second, because the LDP is an agglomeration of factions rather than a cohesive party, there is no one within the LDP who can challenge Koizumi for the leadership. Every potential challenger can only muster the backing of his

23. Translated and abridged in Koizumi Junichiro and Shiroyama Saburo, "Battling Headwinds to Achieve Reform," *Japan Echo*, vol. 29, No. 3 (June, 2002), p. 11.

24. "Koizumi naikaku shiji, kyushin 65% ka hansu, choki seiken nozomu" (Support for Koizumi Cabinet Surpasses a Majority, Reaching 65%), *Mainichi*

*Shimbun*, September 24, 2003, online at [www.mainichi.co.jp](http://www.mainichi.co.jp); "Mutohasa no 56% ga minshu ni tohyo...deguchi chosa bunseki" (56% of Uncommitted Vote for Democrats...Exit Poll Analysis), *Yomiuri Shimbun* (Tokyo), November 10, 2003, online at [www.yomiuri.co.jp](http://www.yomiuri.co.jp).

25. Ray Christensen, *Ending the LDP Hegemony* (Honolulu: University of Hawai'i Press, 2000), p. 193.

respective faction, and none boasts Koizumi's backing by the people.<sup>26</sup> Third, the LDP operates essentially without opposition. Though there are opposition parties, none of them has been able to field a credible candidate for leadership who has any popular appeal. The recent merger of the Democratic Party of Japan (DPJ) and the Liberal Party combined the forces of two opposition parties, but neither has an outstanding candidate with mass appeal.<sup>27</sup>

Perhaps many have wondered why, given his popular appeal, Koizumi has not defected from the LDP and taken many of the younger, more reform-minded LDP members with him? If successful, this strategy could potentially deal a deathblow to the LDP. Yet this strategy would carry with it a lot of risk. Regardless of the difficulties he faces in his current position, Koizumi controls the agenda. If he were to gamble on defection and lose, his control would be lost.

Based on observation, it is, however, plausible that Koizumi is using the oldest negotiation tactic in the book. By asking for more than he expects, he is prepared to compromise for less. This would explain the pattern that emerged during his first term:

- Koizumi seeks full privatization of the postal system, but instead he is only allowed to open the mail delivery business to competition.
- Koizumi seeks full privatization of the four road corporations, but instead is only given permission to appoint a panel of experts to map out the process. (Notice that Koizumi, not the LDP leadership, gets to make the appointments.)
- Koizumi wants to privatize or abolish all public corporations but instead is only allowed to cut public works budgets by nearly 14 percent over two years—not an inconsiderable amount. (A year later he is actually allowed to begin the process of privatization of 118 out of 163 public corporations.)
- Koizumi's government wants to tighten capital requirements on

26. As was seen during the September 2003 LDP presidential election, not even the most powerful faction leaders were able to control how all of their members voted.

27. The strong showing of the DPJ in the November 2003 lower house election may yet signal a trend toward their ultimate viability as a competitive opposition party.

the banks but instead can only go through the back door by applying pressure to the banks' auditors, thereby forcing the *de facto* nationalization of Japan's worst-performing large bank.

- Koizumi wants to deregulate all of Japan but instead is only allowed to open experimental Special Zones for Structural Reform.

To be sure, some of Koizumi's reforms, especially those among his deregulation efforts, are so small as to escape attention, but maybe that is the whole point—to simply survive for as long as possible while gradually pecking away at the old order. Every proposed reform is like a game of political “chicken” in which Koizumi squares off against the LDP; they race toward each other, and at the last minute, Koizumi is the one to flinch. The LDP old guard believes it has emerged victoriously, while Koizumi takes home a consolation prize. The LDP old guard decides it can continue to tolerate Koizumi until the next election, while Koizumi chips away another piece of the foundation that is keeping the LDP in power.

Koizumi is certainly not the first to propose reforms. Other LDP prime ministers have managed to push through reforms in the past as well. Nakasone privatized the railways. Hashimoto pushed through the “Big Bang” reforms to Japan's financial system. Even Mori reorganized the government ministries. But none of them came into office with the reputation of being a maverick and a reformer; none of them was able to maintain the level of popular support that Koizumi commands; and none of them managed to enact more than a handful of reforms.<sup>28</sup> Like all other LDP prime ministers before them, their efforts were directed toward maintenance of the *status quo*.

The one thing that all previous reforms have in common with those of Koizumi is that they took a long time. It took over ten years to privatize Japan's railway system, and there are still elements of the old system imbedded within the government. Some elements of the Big Bang were not enacted until 2000, four

28. Hashimoto initially enjoyed high approval ratings but lost support, presumably for capitulating to the LDP old guard by appointing a scandal-tainted LDP member to his cabinet. Narita Norihiko and Eda Kenji, “How the Prime Minister is Kept from Leading,” *Japan Echo*, vol. 29, No. 3 (June, 2002), p. 14.



years after the law was passed. It is reasonable, therefore, to expect that privatization of an organization as unwieldy as Japan's postal system, if it ever happens, will occur through incremental steps, over an extended period of time. Koizumi himself has been clear about how much time he expects his reforms to take:

We're now taking a close look at the reforms of Ronald Reagan in the United States and Margaret Thatcher in Britain; in both of their cases it took five or six years for the results of their reforms to be felt. . . . If you set out looking for visible results right away, you're invariably going to be disappointed.<sup>29</sup>

In 1997, after Koizumi was unsuccessful in pushing then Prime Minister Hashimoto to move forward with postal privatization, he was quoted as saying, "One person alone does not make politics, but I think it's worth testing to see what a single person can do."<sup>30</sup> Perhaps we are seeing only the beginnings of Koizumi's experiment in changing Japan.

The only remaining question, then, is: How much time will Koizumi have? Some observers have speculated that Koizumi's position vis-à-vis the LDP old guard was weakened somewhat by the less-than-spectacular results achieved by LDP candidates during the November 2003 election. Still others believe that, given the downward trend in the number of LDP-held Diet seats and the upward trend in DPJ-held seats, and given the LDP's continued simple majority in the Diet, the LDP old guard, seeing that its time is running out, may have even further incentive to compromise with Koizumi on his reform plans. Assuming he can continue to deliver electoral victories for the LDP and thereby maintain his position as prime minister, Koizumi's second and final term will end in 2006. Unless the pace of reform is significantly increased during his second term, history will remember Koizumi as neither a lionheart nor a paper tiger.

29. Koizumi and Shiroyama, "Battling Headwinds," p. 11.

30. Stephanie Strom, "Crusader Takes on the Postal Piggy Bank," *New York Times*, November 18, 1997, p. D1.

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